Tax FAQs 2015

Barry Kernon talking to the Editor James McConnachie

Thank you for speaking to The Author, Barry. What are the top mistakes authors make on their tax returns?

Barry Kernon: The most common error is to show income after deduction of agent's commission and VAT. Gross income (i.e. income before deductions) should always be shown, with a separate business expenses claim being made for the commission and VAT costs. To put it another way, the actual tax liability is on the net payment after deduction of the commission, but HM Revenue and Customs (HMRC) needs to be made aware of both the full, gross amount of the advance, and the expense claim you make for the commission you pay.

Apart from being the technically correct way of making the declaration, showing the income after deductions may lead to an enquiry by HMRC because they will have received a declaration either from your publishers or literary agent showing the full figure.

Note that money is deemed to have been received by the author when the agent receives it, not when the agent passes it on to the author.

There are also a couple of common omissions: student loans need to be mentioned, as does child benefit where either spouse or partner earns in excess of £50,000 per annum.

What tax issue most confuses authors?

'Payments on account' sometimes cause confusion, particularly in the early days of the profession. Tax on the previous tax year's income is payable on 31st January but it often comes as a surprise that payment of another 50% is due on the same day – this being a payment on account for the then-current tax year. A further 50% payment is due on 31st July.

You can apply to HMRC to reduce payments on account if you know that your income in the current tax year is going to be lower than it was in the previous tax year: you simply make an estimate to HMRC of your lower income. But there is a catch: if it turns out that your final income for that tax year is higher than your estimate, you are liable to pay interest on the difference.

What about this new 'cash basis'?

This year a new problem has cropped up, in the form of the 'cash basis'. This is a way of preparing your accounts under which the date recorded for any earnings or expenses matches the date the actual cash goes into or leaves your account. Any self-employed author who earns less than £82,000 a year (and hasn't formed a limited company) can use the cash basis.

In the traditional 'earnings basis', authors prepare accounts on the basis of what is earned in a year: this means earnings from any pieces written and invoiced, or payments falling due as per the contract, whether or not actually received in the tax year concerned.

The cash basis is relatively simple, but where accounts are prepared on the earnings basis any losses can be offset against other income in the same year, or in the previous year, and this is not available when using the cash basis.

Authors' averaging of profits also confuses, sometimes…

What is averaging? Why is it aimed at authors? Under what circumstances might it be useful?

In the HMRC terminology, this is called 'averaging for creators of literary or artistic works'. It can only be claimed where profits fluctuate. If one year's profit is less than 75% of the profit of the adjoining year, a claim can be made.

Averaging does not spread tax liabilities forwards or backwards, it is simply a calculation designed to reduce the tax payable in the second of two adjoining tax years, the adjustment being calculated by reference to the average of the profits for the two years. The claim can only be made on the tax return relating to the second of the two years subject to averaging. It takes the form of an adjustment, calculated by reference to the profits of both years, but the tax for the earlier year is unaffected.

For example, if you earned £10,000 in year 1 – you were researching – and then in year 2 you got a bumper advance and a slew of rights deals that took your earnings up to a dizzy £40,000, then, when you submitted your tax return for the second year, you would claim averaging. This would result in the HMRC treating your income as being £25,000 over each of the two years (total income of £50,000, divided by two). This spreads the tax advantages more evenly, and is particularly advantageous if you would have otherwise ended up paying tax at a higher rate in one of the two years.

In a series of fluctuating years, you might have to decide which of two adjacent years it is most advantageous to average.

Which countries, from which authors most commonly earn royalties, are covered by the Double Taxation Agreement? In other words, when I see my royalty statement, which countries should trigger me into taking action to avoid paying tax twice? And how do I do it?

The UK has double taxation agreements with most countries. It is the author's responsibility to minimise the tax paid in the other country. If a tax can be avoided or reduced, and the author does not take action to organise this, HMRC can deny the relief – which means they may not allow you to offset the tax paid abroad against the tax due in the UK.

Claims should always be made under the applicable double taxation agreement. Claim forms have to be certified by HMRC and there are generally standard forms available for completion.

Will I still be liable to pay UK tax on royalties if I go to live abroad?

No, there is an exemption that covers any bona fide author carrying on the profession outside the UK. This is regardless of whether there is a double taxation agreement in place.

Is it better to have one account for work and one for personal?

It is quite useful to have a separate account for work, because all authorship income is then recorded in one place, together with any authorship expenses. However, there will always be expenses such as home, telephone and car costs etc that will not be entirely for business and may well be paid through a personal bank account.

Can you recommend good, foolproof software for keeping tax records?

I would hesitate to use the word 'foolproof', but Excel is good and reliable. Using a spreadsheet with a column for each expense heading is a suitable method of recording expenses and will save you or your accountant time in the preparation of your tax return.

If I am earning very little – just a few bits from PLR and ALCS and the odd royalty – do I still need to submit a tax return? Even if it's just £100 or so?

As long as you maintain that you are continuing as a professional author, HMRC will require a tax return. If you say you have ceased, HMRC might discontinue the tax return process, but you will still need to notify them of the income from time to time, so that tax can be collected.

I know a number of authors who operate through limited companies. Is this a good thing?

Because the corporation tax rate for companies is 20%, compared with combined income tax and national insurance rates of up to 47% for individuals, many people do operate through limited companies. It is generally beneficial over a profit level of about £30–35,000 per annum. Authors should not, however, assign copyrights into limited companies without taking professional advice, because there can be substantial tax disadvantages if the matter is handled incorrectly.

VAT: how much do you need to be earning, in practice, before you should start thinking about charging VAT? Bearing in mind the hassle of quarterly returns…

The compulsory registration limit is £82,000 UK earnings in any consecutive 12 months. Once you have exceeded this limit, you have 30 days to register. There is a penalty for registering late.

The submission of quarterly returns is quite simple. These are done online and if you operate under what is known as the Flat Rate Scheme, where you simply pay a Flat Rate of VAT without claiming VAT on expenses, the completion of returns is very easy indeed. You just add up the income, including VAT, and pay over a percentage.

It is also possible to register voluntarily for VAT at any time and authors will always save money by doing so. This is because HM Revenue and Customs are encouraging people to use the scheme – it simplifies the administration process for them. Most authors will qualify for the Flat Rate Scheme.

And how does the Flat Rate Scheme work?

Currently, for authors, the percentage of your income you pay to HMRC as VAT is 12.5% (and, in the first year of membership of the Flat Rate Scheme, the rate is 11.5%). Given that you charge all clients VAT at the standard rate of 20%, there is clearly a margin in your favour – although under the Flat Rate Scheme you do not get to claim back VAT on expenses (except for any equipment purchases where the item costs £2,000 or more, including VAT.)

My agent charges VAT; how does it affect me?

If you have a VAT-registered agent, they will charge VAT on top of their UK commission, and if you yourself are not VAT registered that's just something you have to live with. If you are VAT registered, you can claim it back.

What expenses do authors frequently forget to claim?

The most common omission, or understated claim, is that of use of home as office. Where a room is furnished as an office, a claim for running costs can be made for 365 days a year. The expenses claimed can include rent or mortgage interest, council tax, buildings insurance, contents insurance, repairs and decorating, service charges, light heat and power.

You typically calculate these by working out what proportion of your home is taken up by your office. You might, for instance, claim a fifth of all bills as office costs if you have five rooms in your house, one of which is your office.

Where a room is furnished as an office but not in constant use as an office, light heat and power costs need to be restricted to actual usage.

HMRC sometimes want a single total expenses claim, but sometimes want it broken down under categories, e.g. 'accountancy, legal and professional fees' and 'property and equipment'. So which of HMRC's expenses categories should these common authors' expenses be logged under? For example, are books bought for research 'office costs? or 'property and equipment'? What about journal and magazines subscriptions? Union subscriptions? Plays and films and museum tickets? Office equipment, e.g. a desk lamp and a printer? Stationery and stamps?

A detailed expenses claim is only required where the author's turnover is above the VAT registration limit, currently £82,000 per annum.

All the items listed can go under office costs except for equipment, which will always be the subject of capital allowances. A detailed record should be kept so that any HMRC enquiries can be answered.

Can an author claim that most cultural expenditure, e.g. books and theatre tickets, are business expenses, as it all feeds into the work? Or does it have to be only very directly related expenses? As another example, I have a Netflix subscription. Some of the films relate to my work, while some are family films. Can I claim for a percentage of the subscription?

Authors can generally claim that most cultural expenditure e.g. books and theatre tickets, is business related but it is generally advisable to exclude a percentage to cover any private element. The same applies to the Netflix subscription.

Should you keep all receipts, or only those for things you are going to claim for as business expenses? Should you file them by tax year? Putting them on a spike?

We generally recommend keeping all receipts, business and domestic, together with annotated bank statements and credit card statements, and any related records, for a period of six years from the end of each tax year. Keeping non-business items helps to demonstrate to HMRC that private expenses have been excluded from any claims.

It is helpful to file, tax year by tax year, and preferably in a file or folder, rather than on a spike.

What happens if both people in the household are self-employed and working at home? Can both of them claim a fair proportion of the total household costs? What if one person has paid the phone bill and the other the heating?

Claims are based on the expenses incurred. It does not matter which member of the household pays them. If one room is used as an office, this can be claimed, but only once. Some people claim half each. Others have a room each. The appropriate proportion of telephone and heating costs can be claimed by both as individual professionals.

Capital allowances and 'writing down allowances' sound complicated. When I buy a new laptop, do I have to claim it as a capital allowance or can I just put it through as an office cost?

Currently, any item bought during a tax year can be claimed in full under the heading of 'annual investment allowance'. But he rules do change from time to time.

'Writing down allowance' only applies to items bought or introduced into the business in an earlier tax year and not wholly claimed at the time. In these circumstances a claim is made for 18% of the reducing balance of this expenditure. The balance can be written off once it reaches £1,000. It is not necessary to claim the full available allowance if it is not beneficial to do so. Instead the balance can be carried forward to be claimed in later years.

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